

VZCZCXRO2266
RR RUEHDE
DE RUEHCV #2667/01 2491206
ZNY CCCCC ZZH
R 061206Z SEP 06
FM AMEMBASSY CARACAS
TO RUEHC/SECSTATE WASHDC 6145
INFO RUEHHH/OPEC COLLECTIVE
RUEHAC/AMEMBASSY ASUNCION 0682
RUEHBO/AMEMBASSY BOGOTA 6972
RUEHBR/AMEMBASSY BRASILIA 5759
RUEHBU/AMEMBASSY BUENOS AIRES 1450
RUEHLP/AMEMBASSY LA PAZ 2326
RUEHPE/AMEMBASSY LIMA 0574
RUEHSP/AMEMBASSY PORT OF SPAIN 3237
RUEHQT/AMEMBASSY QUITO 2414
RUEHSG/AMEMBASSY SANTIAGO 3756
RUEHDG/AMEMBASSY SANTO DOMINGO 0306
RHEHAAA/WHITEHOUSE WASHDC
RHEBAAA/DEPT OF ENERGY
RUCNDT/USMISSION USUN NEW YORK 0490
RUCPDO/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
RHEHNSC/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 002667

SIPDIS

SIPDIS

ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD
NSC FOR DTOMLINSON

E.O. 12958: DECL: 07/07/2016

TAGS: [ECON](#) [ENRG](#) [EPET](#) [EINV](#) [VE](#)

SUBJECT: STRATEGIC ASSOCIATION MIGRATION: THE GAME'S AFOOT

REF: A. CARACAS 910

[1](#)B. CARACAS 2297

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

[1](#)1. (C) SUMMARY: After months of speculation, the BRV has contacted international oil companies (IOCs) with stakes in the Faja strategic associations to begin negotiations on migrating the associations to joint ventures in which PDVSA holds a majority stake. Although the BRV has spoken with individual companies, the IOCs are still waiting for written proposals. It is not clear to what extent financing covenants will protect the IOCs. We expect the BRV to push for some sort of agreement before the December presidential elections. END SUMMARY

THE GAME'S AFOOT

[1](#)2. (U) The four Faja strategic associations (Sincor (Total 47%, PDVSA 38%, Statoil 15%); Petrozuata (ConocoPhillips 50.1%, PDVSA 49.9%); Ameriven (ConocoPhillips 40%, Chevron 30%, PDVSA 30%); and Cerro Negro (ExxonMobil 41.67%, PDVSA 41.67%, BP 16.67%)) produce roughly 620,000 barrels of extra heavy crude per day. Private sector estimates of total Venezuelan crude production range from 2.4 to 2.6 million barrels per day. The extra heavy crude is sent to four dedicated upgraders which in turn convert it into syncrude with APIs of between 15.5 (Cerro Negro) and 30.9 (Sincor).

[1](#)3. (C) Senior executives at ExxonMobil (strictly protect) told Petroleum Attache (Petatt) that Energy Vice Minister Bernard Mommer met with them in late August and stated the BRV was formally beginning negotiations on the migration of the strategic associations to joint ventures in which PDVSA holds a majority stake. A ConocoPhillips executive (strictly protect) also confirmed that his company has begun discussions regarding the migration of their two strategic associations.

14. (C) An ExxonMobil executive told Petatt on September 5 that Vice Minister Mommer promised the BRV would provide ExxonMobil with a "terms sheet" that would set out specific proposals for the migration within a week of their meeting. Almost three weeks have passed and ExxonMobil is still waiting for the terms sheet. The executive also stated the BRV first approached ConocoPhillips and asked it to provide the BRV with its list of proposals for the migration. ConocoPhillips decided that it was in its best interests not to provide the BRV with its proposals. The ExxonMobil executive likened the BRV's request to asking someone to provide the rope that will be used to hang him. After ConocoPhillips failed to provide the proposals, the BRV decided to begin negotiations with its own list of proposals.

15. (C) According to ExxonMobil executives, the new joint ventures will be formed roughly along the lines of the joint ventures formed from the operating service agreements (OSA) earlier this year (Reftel A). Although BRV officials originally stated publicly that PDVSA wanted a 60% stake in the new joint ventures, it now appears that it is willing to accept a 51% stake. The royalty and tax structures of the new joint ventures will also be similar to the former OSA joint ventures. A tax bill that raises the income tax rate for the strategic associations from 34 to 50% is currently winding its way through the (all-Chavista) National Assembly. The BRV stated it will compensate the association partners for their lost value stemming from the migration by allowing the new joint ventures to significantly increase their production. (COMMENT: Any significant increase in production would require IOCs to invest substantial sums in the new joint ventures. The BRV is clearly calculating that the IOCs

CARACAS 00002667 002 OF 003

are still willing to invest billions in Venezuela in exchange for increased production and future investment opportunities in the Faja region. However, given the lack of legal certainty in Venezuela, it is not clear that many of the IOCs are willing to significantly increase their exposure. END COMMENT)

16. (C) The ExxonMobil executives also stated the BRV has suggested that the four upgraders be separated from the fields that supply them. The new tax bill reinforces this proposal by preserving the 34% tax rate for entities that exclusively upgrade or refine crude oil. (COMMENT: It is not clear exactly why the BRV is differentiating between the fields and upgraders. We suspect the policy stems from two factors. First, PDVSA desperately needs the IOCs' expertise in running upgraders and refineries. As recent accidents have shown, PDVSA does not have the human capital to run its current refineries, much less the strategic association upgraders or new refineries (Reftel B). Second, reclaiming oil fields fits perfectly with the Chavez administration's past political rhetoric of reclaiming Venezuela's patrimony and sovereignty and eliminating the "opening" of the hydrocarbon sector. As a result, the migration of the strategic association's fields is the perfect fodder for a campaign speech. Assuming majority control of upgraders and refineries does not provide the same political "bang for the buck" and only creates additional operating problems for PDVSA. END COMMENT)

POTENTIAL ROADBLOCKS FOR THE BRV

17. (C) The ExxonMobil executive said Vice Minister Mommer stated he believes the strategic association migration will be easier than the OSA migration because the agreements creating the strategic associations are legal. When Petroleum Attache stated he did not understand Mommer's logic, the ExxonMobil executive admitted that he did not either. Given the fact that the BRV acknowledges that the strategic associations are legal, it is readily admitting that it does not have a legal basis for forcing the companies to migrate.

¶8. (C) Although the BRV may not have a legal basis for forcing the migration, it can encourage the IOCs to migrate just by making life difficult for them. The ExxonMobil executive stated his company recently requested a production increase at Cerro Negro in order to make up for a scheduled maintenance shutdown. The production increase would allow Cerro Negro to reach its average yearly production figure. The BRV agreed to the production increase but only if ExxonMobil and BP agreed to waive their arbitration rights. ExxonMobil rejected the production increase and BP sent a letter to ExxonMobil and PDVSA stating ExxonMobil's position had rendered its decision moot. (NOTE: Under the terms of the strategic association, all of the partners have to agree to production changes. END NOTE)

¶9. (C) The BRV also faces a significant obstacle in the form of financing covenants. At least two of the strategic associations, Ameriven and Petrozuata, have loans or bonds that contain covenants governing changes in equity. Under the covenants, the strategic association partners cannot change the equity structure of the associations without the creditors' permission. A senior Chevron executive (strictly protect) told the Economic Counselor and Petatt in July that he believes the financing covenants will prevent the BRV from migrating the strategic associations to joint ventures. According to the executive, the IOCs can say they would like to cooperate but the creditors will not let them do so. (COMMENT: The obvious weakness in this theory is that the BRV and PDVSA can always repay the loans and purchase the bonds.

CARACAS 00002667 003 OF 003

Although this would be quite expensive, the BRV and/or PDVSA could always refinance the projects using loans from banks. END COMMENT)

COMMENT

¶10. (C) We believe that the BRV wants to have some sort of agreement on the migration before the elections. The agreement could be anything from a non-binding memorandum of understanding to a transition agreement along the lines of the transition agreements used in the OSA migrations (Reftel A). An agreement would give President Chavez the perfect opportunity to claim that he has reestablished Venezuelan sovereignty and completely dismantled the "opening" of the Venezuelan hydrocarbon sector. Although the Chevron executive thought the BRV would be satisfied with a non-binding MOU, we do not share his optimism. The BRV may be temporarily satisfied with some form of weak agreement before the elections, but we firmly believe that the BRV will eventually, by hook or by crook, force the migration of the strategic associations to joint ventures. In our view, the question is not "if" but rather "how" and "when".
WHITAKER